**Declaratory Ruling 2005-048-M**

**The assisted housing risk management association**

October 6, 2005

## I. BACKGROUND

A. The Request for Declaratory Ruling

The Assisted Housing Risk Management Association (the "AHRMA") filed a Request for Declaratory Ruling with the Commissioner of the Office of Financial and Insurance Services on a question it states as follows:

> Whether municipal corporations in Michigan may lawfully become members of a self-insurance pool that consists of out-of-state municipal corporations.

B. The Scope of this Declaratory Ruling

Section 63 of the Michigan Administrative Procedures Act of 1969 (the "APA"), MCL 24.263, authorizes agencies to issue declaratory rulings on request of an interested person and requires agencies to prescribe rules for the form, submission, consideration, and disposition of such requests. Pursuant to section 63, the Insurance Bureau adopted administrative rules that require a person who requests a declaratory ruling to state all the known facts relevant to the determination and to identify the pertinent statutes and rules. 1979 AC, R 500.1041. Moreover, the rules require that any declaratory ruling shall state that it is limited to the facts, statutes, and rules identified by the applicant or statutes or rules identified by the commissioner. 1979 AC, R 500.1043(2).

These rules serve the common-sense purpose of making declaratory ruling requests manageable. This agency is not required to anticipate all possible statutory objections that might be raised to a planned course of action. Instead, the applicant has the obligation to certify that it "has identified all statutes and rules which the applicant seeks to have considered by the commissioner in making the ruling." 1979 AC, R 500.1041.

In conformity with these rules, this declaratory ruling is limited to those facts, statutes, and rules specifically identified by the AHRMA in its request and any other statutes or rules identified by the Commissioner. The Request identifies the following as the relevant statutes or rules:

- Const 1963, art 3, s 5.

- The Intergovernmental Contracts Between Municipal Corporations Act, MCL 124.1 et seq.

- Section 402 of the Michigan Insurance Code, MCL 500.402.

- 42 USC s 1436c.

- 24 CFR Parts 905 and 965.

Accordingly, this declaratory ruling does not consider or determine whether the AHRMA and municipal corporations would violate other statutes or rules if they undertake the proposed course of action. Pursuant to section 63 of the APA, this declaratory ruling is binding on both the AHRMA and the Commissioner "unless it is altered or set aside by any court," although it may be prospectively changed by the Commissioner. MCL 24.263.

C. Facts stated in the Request

The AHRMA asserts in its Request that it is a nonprofit entity formed under the Illinois Intergovernmental Cooperation Act, 5 Ill Comp Stat 220/1 et seq, for the purpose of providing insurance coverage to its members by way of a pooling agreement. Its members are 149 public housing agencies in Illinois, Iowa, and Nebraska. The AHRMA provides its members with multi-line insurance including general liability, public official's liability, auto liability, worker's compensation, and public employee dishonesty coverage. The Request states that the AHRMA has been providing coverage to public housing agencies for almost twenty years. The U.S. Department of Housing and Urban Development ("HUD") conditionally approved the formation of the AHRMA in a March 25, 1986 letter, which is attached to the Request.

The AHRMA asserts that Illinois law, 5 Ill Comp Stat 220/1 and 220/6 (2005), expressly authorizes intergovernmental cooperation with public subdivisions of other states to jointly provide coverage under a pooling agreement. It says that the insurance departments in Iowa and Nebraska approved the AHRMA to operate in those states by separate letters attached to the Request. Without naming any particular entity, the Request asserts that several housing commissions in Michigan have expressed an interest in joining the AHRMA's self-insurance pool. The AHRMA is asking for a declaratory ruling confirming that the Michigan housing commissions may join the AHRMA under Michigan law.

## II. ANALYSIS

A. The Insurance Code prohibits any person from acting as an insurer in this state without a certificate of authority from the Michigan Commissioner. The AHRMA acts as an insurer by operating a group self-insurance pool.

The Michigan Insurance Code of 1956 (the "Insurance Code"), MCL 500.100 et seq., establishes a comprehensive system for licensing and regulating the insurance business in Michigan. Section 402 of the Insurance Code, MCL 500.402, forbids any person from

acting as an insurer or otherwise transacting insurance in this state without a certificate of authority granted by the Commissioner {Footnote 1} under the Code. Section 402 reads:

> No person shall act as an insurer and no insurer shall issue any policy or otherwise transact insurance in this state except as authorized by a subsisting certificate of authority granted to it by the commissioner pursuant to this code.

The Code defines "person" broadly to include any individual and any legal entity. MCL 500.114.

Under section 402a of the Code, MCL 500.402a, issuing or delivering insurance contracts, soliciting applications for insurance contracts, collecting insurance premiums for insurance contracts, and doing or proposing to do any act "in substance equivalent to" these actions, all constitute "transactions of insurance" that require a certificate of authority from the Commissioner. Section 402a states:

> In this state, the following transactions of insurance, whether effected by mail or otherwise, require a certificate of authority:
>
> > (a) The issuance or delivery of insurance contracts to residents of this state.
> >
> > (b) The solicitation of applications for insurance contracts from residents of this state.
> >
> > (c) The collection of premiums, membership fees, assessments, or other consideration for insurance contracts from residents of this state.
> >
> > (d) The doing or proposing to do any act in substance equivalent to subdivisions (a) to (c).

Group self-insurance pools, like the AHRMA, engage in transactions of insurance. They provide coverage for their members by pooling or sharing their members' individual risks. They pay their members' claims from a fund created by the members' payments in the same way traditional commercial insurance companies pay claims from the pool of money created by their policyholders' premiums. In both cases, the risk of loss shifts from the individuals and is jointly shared through their contributions to a common fund. This transfer and sharing of risk is the hallmark of insurance. Health Care v Transamerica, 167 Mich App 218, 226; 421 NW2d 638 (1988) ("The transfer of risk away from the insured is the distinguishing characteristic of an insurance plan."); 1 Appleman on Insurance 2d, s 1.3, p 10 ("[R]isk sharing is the keystone to the nature of insurance."). Thus the pools' contracts with their members are at least "in substance equivalent to" insurance contracts and the pool members' payments are at least "in substance equivalent to" premiums for those contracts. Therefore, if the AHRMA were to

deliver contracts, solicit applications, or collect premiums in Michigan, under section 402a of the Code, it would engage in "transactions of insurance" requiring a certificate of authority from the Michigan Commissioner.

In its declaratory ruling request, the AHRMA acknowledges that it is engaged in pooling and sharing the risks of its members and it does not deny that this arrangement usually constitutes insurance. But, it asserts that under the Intergovernmental Contracts Between Municipal Corporations Act (the "Intergovernmental Contracts Act"), MCL 124.1 et seq., municipal group self-insurance pools are not insurance companies or insurers. (Request p 3).

B. The Intergovernmental Contracts Act authorizes municipal corporations to form self-insurance pools to provide specified coverages without obtaining a certificate of authority from the Commissioner if the pools are formed pursuant to the Act.

In 1982 the Michigan Legislature amended the Intergovernmental Contracts Act to expressly authorize municipal corporations to form group self-insurance pools. 1982 PA 138. This legislation was driven by the perception that a municipal liability insurance crisis had arisen due in part to the erosion of governmental immunity as a defense for municipalities. Senate Legislative Analysis, May 17, 1982, p 3. It was argued that authorizing such pools would improve comprehensive risk management programs, reduce premium costs, and expand the member municipalities' resources for purchasing coverage. Senate Legislative Analysis, May 17, 1982, p 1.

Although the Legislature authorized municipal corporations to form pools, it also mandated certain safeguards, including:

- Intergovernmental contracts forming pools must include a financial plan and plan of management, MCL 124.7;

- The intergovernmental contract must be submitted to the Insurance Commissioner, who shall review it for compliance with the Act, MCL 121.7a(1);

- The pool must obtain at least $5,000,000 in aggregate excess loss insurance or make a deposit with the State Treasurer in a like amount, unless the Commissioner approves a lesser amount, MCL 124.7a(3);

- The pool must file annual audited financial statements with its members and with the Commissioner, MCL 124.8(1); and

- The pool may only invest its assets in securities and investments permitted for insurers under the Insurance Code, MCL 124.11.

The Act also expressly forbids municipal corporations from forming a group self-insurance pool other than pursuant to the Act. MCL 124.5(7).

Therefore, although section 6 of the Intergovernmental Contracts Act, MCL 124.6, expressly provides that municipal group self-insurance pools formed under that Act are not insurance companies, the Act provides that such pools are regulated by the Commissioner as set out in the Intergovernmental Contracts Act itself.

C. The AHRMA was not formed and does not operate pursuant to the Intergovernmental Contracts Act. Therefore it may not provide coverage to municipal corporations in Michigan without first obtaining a certificate of authority from the Commissioner.

The AHRMA asserts that it is not required to obtain a certificate of authority from the Michigan Commissioner because under section 6 of the Intergovernmental Contracts Act, MCL 124.6, municipal group self-insurance pools are not insurance companies and their pooling of risks does not constitute insurance. Request, p 3. But, section 6 only applies to pools organized and operating under the Michigan Intergovernmental Contracts Act. It does not apply to pools, like the AHRMA, formed under the laws of other states. Section 6 reads as follows:

> Any group self-insurance pool organized pursuant to section 5 is not an insurance company or insurer under the laws of this state. The development, administration, and provision of group self-insurance programs and coverages authorized by this act by the governing authority created to administer the pool pursuant to section 7(c) does not constitute doing an insurance business. [MCL 124.6 (Emphasis added)]

The AHRMA was not organized and does not operate under the Michigan Intergovernmental Contracts Act. To the contrary, the AHRMA asserts on page one of its Request for Declaratory Ruling that the intergovernmental agreement between its members was formed pursuant to Illinois law.

The Intergovernmental Agreement between AHRMA's public housing agency members was formed pursuant to the State of Illinois' Intergovernmental Cooperation Act, 5 Ill Comp. Stat. 220/1 et seq.

According to its Request, the AHRMA's members are public housing agencies in Illinois, Iowa, and Nebraska. While the Commissioner's records show fourteen municipal group self-insurance pools formed under the Michigan Intergovernmental Contracts Act, the AHRMA is not one of the fourteen. {Footnote 2}

Because the AHRMA was formed pursuant to Illinois law, the declaration in MCL 124.6 that self-insurance pools formed under Michigan law are not insurance companies does not apply to the AHRMA. Therefore the AHRMA may not solicit Michigan municipalities for participation in the AHRMA group self-insurance pool, deliver contracts providing coverage, or collect payments for coverage without obtaining a certificate of authority as an insurer under the Michigan Insurance Code. {Footnote 3}

This conclusion is fully consistent with the language and purpose of the Intergovernmental Contracts Act. In order to protect the public, Michigan law generally forbids any person from acting as an insurer without complying with the Insurance Code's restrictions and limitations. Obviously, an insurer that is financially unable to pay claims or otherwise refuses to honor its commitments puts the public at risk. The Intergovernmental Contracts Act created what amounts to an exception to the certificate of authority requirement for municipal group self-insurance pools, but the exception is carefully limited to group self-insurance pools formed under the Act. The Act specifically forbids municipalities from forming group self-insurance pools in any other way. MCL 124.5(7). This guarantees that pools formed by municipal corporations must at least comply with the limited safeguards in MCL 124.5 through 124.12b. If municipal corporations were to participate in pools formed under the laws of other states, there would be no assurance that the pools incorporate the safeguards the Michigan Legislature mandated in the Intergovernmental Contracts Act. Thus it makes perfectly good sense to do what the Legislature did: namely, to limit the functional exemption from the Insurance Code contained in section 6 of the Intergovernmental Contracts Act to just those group self-insurance pools formed under the Michigan Act.

This analysis is not intended to disparage the financial soundness, lawfulness, or good faith of the AHRMA. The Commissioner has not reviewed the AHRMA's financial statements, plan of operations, or contracts. Presumably the Michigan Legislature could have authorized the AHRMA to operate in Michigan without a certificate of authority fit believed that was good public policy. But it has not done so. {Footnote 4}

D. Federal law does not preempt Michigan law limiting municipal corporations to self-insurance pools formed pursuant to the Intergovernmental Contracts Act or requiring that the AHRMA first obtain a certificate of authority before providing coverage in Michigan.

The AHRMA also asserts that federal law preempts state law to the extent that Michigan law interferes with its plans to have Michigan municipal corporations join the AHRMA.

[E]ven if Michigan law could be read to disallow interstate self-insurance pools, AHRMA contends the state law would be preempted by federal law in this area. See Ayers v Philadelphia Housing Authority, 908 F2d 1184 (3rd Cir 1990); Thorp v Housing Authority of the City of Durham, 393 US 268 (1969). [Request p 5.]

The U.S. Supreme Court has made it clear that federal preemption of state law involves delicate questions of federalism. Preemption is not favored. To establish federal preemption, the AHRMA must show either that Congress "unmistakably" intended to preempt state law or that the nature of the subject matter regulated "permits no other conclusion." In Alessi v Raybestos-Manhattan, Inc. 451 US 504, 522; 101 S Ct. 1895; 68 L Ed 2d 402, (1981), the Court summarized the ground rules for deciding a federal preemption issue:

> Our analysis of this problem must be guided by respect for the separate spheres of governmental authority preserved in our federalist system.

> Although the Supremacy Clause invalidates state laws that "interfere with, or are contrary to, the laws of Congress . . . .," . . . the "exercise of federal supremacy is not lightly presumed." . . . .As we recently reiterated, "[p]reemption of state law by federal statute or regulation is not favored in the absence of persuasive reasons-- either that the nature of the regulated subject matter permits no other conclusion or that Congress has unmistakably so ordained" . . . . [Emphasis added, citations omitted.]

In addition, for sixty years Congress has recognized the primacy of the states in regulating and taxing the business of insurance in the McCarran-Ferguson Act, 15 USC s 1011 et seq. 15 USC s 1012 provides:

> (a) State regulation. The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> (b) Federal regulation. No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

Thus, the AHRMA begins with a presumption against its position. States have traditionally-and with the blessing of Congress-- exercised the primary responsibility for regulating the business of insurance. On top of that, preemption generally is not favored and requires a showing that Congress unmistakably intended to displace state law. The AHRMA's preemption argument must be evaluated in light of these standards.

The AHRMA first points to 42 USC s 1436c, which it asserts "obviously indicates Congressional policy favoring such inter-governmental pools by public housing agencies, regardless of any other legal requirement of State or Federal law." Request, p 6.

But s 1436c does not support AHRMA's overstated contention. The statutory language quoted by the AHRMA in its Request simply provides that public housing agencies may buy insurance from "a nonprofit insurance entity" owned or controlled by public housing agencies without regard to state or federal competitive procurement requirements. It reads:

> Hereafter, notwithstanding any other provision of State or Federal law, regulation or other requirement, any public housing agency . . . . that purchases any line of insurance from a nonprofit insurance entity, owned

> and controlled by public housing agencies . . . . , and approved by the Secretary, may purchase such insurance without regard to competitive procurement. [42 USC s 1436c (Emphasis added).]

This language only overrides state laws requiring public housing agencies to solicit competitive bids when purchasing any line of insurance from a nonprofit insurance entity owned and controlled by public housing agencies. Of course, no such competitive bidding requirement is at issue here. There is simply nothing in the language that the AHRMA quoted to indicate the Congress intended to supplant state laws in any other regard, let alone state insurance laws as they apply to a nonprofit insurance entity owned or controlled by a public housing agency.

To the contrary, the immediately following language of s 1436c, which the AHRMA omitted from its quotation, demands that HUD defer to state insurance laws regulating investments and fails to express any indication to override state insurance laws.

> Hereafter, the Secretary shall establish standards as set forth herein, by regulation, adopted after notice and comment rulemaking pursuant to the Administrative Procedures Act, which will become effective not later than one year from the effective date of this Act.
>
> Hereafter, in establishing standards for approval of such nonprofit insurance entities, the Secretary shall be assured that such entities have sufficient surplus capital to meet reasonably expected losses, reliable accounting systems, sound actuarial projections, and employees experienced in the insurance industry. The Secretary shall not place restrictions on the investment of funds of any such entity that is regulated by the insurance department of any State that describes the types of investments insurance companies licensed in such State may make. With regard to such entities that are not so regulated, the Secretary shall establish investment guidelines that are comparable to State law regulating the investments of insurance companies. [42 USC s 1436c (Emphasis added).]

Ironically, the March 25, 1986 letter from HUD attached to the Request also contradicts the AHRMA's preemption argument. The letter approves formation of the AHRMA subject to five conditions. The first condition is:

> A legal opinion that the proposed Intergovernmental Cooperation Agreement will be a binding and valid undertaking under state law and also that State competitive bidding laws do not prohibit funding for losses in the matter proposed. [Emphasis added]

This is express acknowledgement by HUD that the intergovernmental cooperation agreement must comply with state law in order to receive federal approval. Thus, rather than indicating the federal law should override state law, the letter indicates that in order for HUD to finally approve the formation and operation of the AHRMA, the AHRMA's

contracts must comply with state law. This thoroughly undermines the AHRMA's argument that federal law intended to override state law.

Likewise none of the three cases cited by the AHRMA support its contention that 42 USC s 1436c preempts the certificate of authority requirement of the Michigan Insurance Code. In fact, two of the three cases have nothing to do with conflicts between federal and state law and therefore do not so much as even mention the concept of federal preemption of state law. In Thorpe v Housing Authority of the City of Durham, 393 US 268; 21 L Ed 2d 474; 89 S Ct 518 (1969) the U.S. Supreme Court held that the local housing authority must comply with a HUD directive issued under its rule-making power requiring housing authorities to provide tenants with the reasons for eviction and afford them an opportunity to reply. But as there was no contrary state law, the case did not so much as even mention preemption. Similarly, Housing Authority of the City of Omaha v US . Housing Authority, 468 F2d 1 (CA 8 1 972) had nothing to do with preemption of state law. That case merely held that HUD had properly promulgated rules so that local housing authorities were bound by them. There was no indication of any conflict with state laws so the question of preemption was not even mentioned.

The only case the AHRMA cited that does deal with preemption is Ayers v Philadelphia Housing Authority, 908 F2d 1184 (CA 3 1990). The Court held that federal housing regulations concerning evictions preempted contrary state law to the extent they applied to home buyers under a federally regulated program. But the case made no mention of federal regulations relative to insurance or to state insurance laws. Therefore the Ayers decision provides no support for the AHRMA's argument that 42 USC s 1436c preempts the certificate of authority requirement of section 402 of the Michigan Insurance Code.

## III. RULING

For the reasons explained above, the Commissioner of the Office of Financial and Insurance Services concludes and declares that:

1. The AHRMA may not solicit any entity, including municipal corporations, for participation in the AHRMA's group self-insurance pool, deliver contracts providing coverage, or collect payments for coverage without obtaining a certificate of authority as an insurer under the Michigan Insurance Code as required by MCL 500.402 and 500.402a.

2. Because the AHRMA was not organized and does not operate under the Michigan Intergovernmental Contracts Act, MCL 124.6 does not apply to the AHRMA and therefore does not excuse the AHRMA from compliance with the Insurance Code.

3. The AHRMA has failed to demonstrate that federal law related to public housing authorities unmistakably indicates that Congress intended to preempt the requirement of the Michigan Insurance Code that the AHRMA must first obtain a certificate of authority before soliciting or

contracting to provide coverage to any entity in this State or that the nature of the subject matter regulated permits no other conclusion. Therefore MCL 500.402 and 500.402a are not preempted by federal law as they apply to the AHRMA.

Linda A. Watters
Commissioner